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A Historical Analysis of the Investment Company Act of 1940

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A HISTORICAL ANALYSIS OF THE INVESTMENT COMPANY ACT OF 1940

*Michael B. Weiner**

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INTRODUCTION

More than 100 million Americans invest \$25 trillion in mutual funds and exchange-traded funds (collectively, “funds”) regulated by the Investment Company Act of 1940 (the “Act”), making funds the predominant investment vehicle in the United States.¹ Everyday investors rely on funds to save for retirement, pay for college, and seek financial security.² In this way, funds demonstrate how “Wall Street” can connect with “Main Street” to improve people’s lives.

By way of background, funds are created by investment advisers (“advisers”) that provide investment advisory (*e.g.*, stock selection) and other services to their funds in exchange for a fee. Investors purchase shares of a fund, which represent a pro-rata interest in the fund’s net assets—essentially, the securities chosen by the adviser—with the hope that the value of those assets, and in turn, the value of the fund, will appreciate. Although managing a fund is expensive, pooling investments from the public allows an adviser to spread its costs over an entire fund, which allows professional money management to be affordable for all.

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1. INV. CO. INST., INVESTMENT COMPANY FACT BOOK, at *i, *31 (2020).

2. Open-End Fund Liquidity Risk Management Programs, Investment Company Act Release No. 31835, 80 Fed. Reg. 62274, 62276 (proposed Oct. 15, 2015) (codified at 17 C.F.R. § 270.22e-4).

Prior to the Act, the unique structural aspects of funds, coupled with a lack of regulation,³ enabled rogue⁴ advisers to put their own interests ahead of those of fund shareholders.⁵ These structural aspects include that a fund typically relies on its adviser, which seeks to make a profit, to manage its day-to-day operations.⁶ Before 1940, adviser personnel also dominated the boards of directors of funds, which are responsible for overseeing the adviser and negotiating its compensation.⁷ This made funds susceptible to rogue advisers that were more interested in managing funds to benefit themselves and their “affiliates” (*i.e.*, their employees and related businesses), as opposed to increasing the value of their funds.⁸

3. U.S. SEC. & EXCH. COMM’N, INVESTMENT TRUSTS AND INVESTMENT COMPANIES: ABUSES AND DEFICIENCIES IN THE ORGANIZATION AND OPERATION OF INVESTMENT TRUSTS AND INVESTMENT COMPANIES, H.R. DOC. 76-279, at 63 (1939) [hereinafter SEC REPORT] (Prior to the Act, specific statutory restraints or governmental regulations “were virtually [absent].”). The SEC Report, which runs thousands of pages and took years to complete, was prepared by the SEC at the direction of Congress (pursuant to Section 30 of the Public Utility Holding Company Act of 1935) after criticism of the fund industry began to mount. In particular, Congress requested the SEC to consider “the influence exerted by interests affiliated with the management of such trusts and companies upon their investment policies.”

4. The term “rogue” is used to convey that most advisers did not engage in the abuses described herein. See S. REP. NO. 76-1775, at 4–5 (June 6, 1940) (“The committee, in recommending this regulatory legislation, does not mean to imply that most [funds] at present operating in this country were guilty of unfair practices or were mismanaged.”). For this reason, the fund industry enthusiastically supported the passage of the Act in an effort to prevent the sins of the few from tarnishing the reputations of many. See *id.* at 12 (“The industry asserted, and the Commission and the committee believe, that this legislation will tend to prevent those abuses which have been a stigma upon and impaired the usefulness of the investment trust industry as a whole.”).

5. See *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Comm. on Banking and Currency*, 76th Cong., at 37 (1940) [hereinafter *Senate Hearings*] (Robert E. Healy, SEC Commissioner testified that “I am constrained to state that too often [funds] were organized and operated as adjuncts to the business of the sponsors and insiders to advance their personal interest at the expense of and to the detriment of their stockholders.”); see also Alfred Jaretzki, Jr., *The Investment Company Act of 1940*, 26 WASH. U. L. Q. 303, 317 (1941) (“The charge had been made that investment companies frequently were operated, not primarily in the interests of their stockholders, but in the interests of controlling groups or groups represented on the board of directors.”).

6. See *Jones v. Harris Assocs.*, 559 U.S. 335, 338–39 (2010).

7. See SEC REPORT, *supra* note 3, at 1919 (describing fund management contracts “empowering the manager to nominate several or all of the directors and officers of the investment company, or requiring approval by the manager of the directors elected by the stockholders.”); see also *Senate Hearings*, *supra* note 5, at 38 (Healy testified that “[b]oards of directors often consist solely or predominantly of representatives of banking, brokerage, or distributor sponsors.”); see also Comment, *The Investment Company Act of 1940*, 50 YALE L. J. 440, 448 (1941) [hereinafter Comment] (noting the Act was going to “result in a big shake-up in substantial institutions such as the Lehman Corporation, for instance, all of whose directors are connected with Lehman Brothers”).

8. Section 2(a)(3) of the Act defines an “affiliated person” to include, among other things, persons or entities with certain degrees of ownership or control over others, business entities under the same corporate umbrella, and various corporate actors of such entities. The Act’s legislative history is replete with examples of improper affiliated transactions. See SEC REPORT, *supra* note 3, at 22 (collecting examples); see *Senate Hearings*, *supra* note 5, at 37 (Healy testifying to same).

Recognizing the vital role that funds play for both the overall economy⁹ and the citizen of “small means,”¹⁰ the Securities and Exchange Commission (SEC) and the fund industry worked together to draft the Act, which Congress passed unanimously.¹¹ The incredible growth of funds over the past 80 years is often attributed to the oversight and direction provided by the Act, which regulates all facets of fund operations and is arguably the most complex of our nation’s securities laws.¹²

Understanding the policy concerns that led to the Act helps to cut through that complexity and make sense of the Act’s provisions.¹³ As a result, this article focuses on those concerns, which can be thought of as guiding “Principles,” to demonstrate how the Act seeks to: (1) prevent insiders from taking advantage of funds they manage; (2) require effective disclosure; and (3) ensure the equitable treatment of shareholders.

The Principles make the Act easier to apply by serving as shoal markers for conduct to avoid. And, just as a buoy indicates danger to one side and safety to the other, the Principles also help to delineate between bona fide conduct and that which to steer clear of. The Principles are thus a useful lens for interpreting

9. See S. REP. NO. 76-1775, at 4–5 (noting that funds are “vitally associated with the national economy” due to their popularity, substantial holdings in various industries, and ability to inject new capital into the economy); see also *Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the Comm. on Interstate and Foreign Commerce*, 76th Cong., at 54–55 (1940) [hereinafter *House Hearings*] (Healy testifying to same).

10. Jaretzki, *supra* note 5, at 308; *Senate Hearings*, *supra* note 5, at 227 (David Schenker, Chief Counsel of the SEC Report, testified that “[w]e say fundamentally this business is a business of furnishing management advice to small investors.”).

11. See 86 CONG. REC. 8843 (1940) (Sen. Robert F. Wagner stated that “[i]t is almost a miracle. I have never known to happen in my experience as a legislator that the industry affected has sought such regulation. There was not a dissenting voice heard from the entire industry affected against the passage of this regulation.”); S. REP. NO. 76-1775, at 2 (noting the Act “has the distinction of having the virtually unanimous support of the persons for whose regulation it provides, as well as of the regulatory agency by which it is to be administered.”); *Senate Hearings*, *supra* note 5, at 1106 (Healy testifying to same); *id.* at 1109 (Alfred Jaretzki, Jr., an attorney testifying on behalf of the fund industry, stated that “[w]e feel that it would be helpful not only to the industry to have this legislation passed now, but also we feel that it is a very healthy sign that Government and industry can come together and do a constructive job of this kind.”). It is worth noting that even though the initial attempt at drafting the Act failed, the SEC and the fund industry worked at a feverish pace to “reach a common ground . . . [As] a “result of their cooperative efforts, the substitute bill . . . was drafted.” S. REP. NO. 76-1775, at 1; see also *Senate Hearings*, *supra* note 5, at 1108 (Jaretzki testified that “working day and night with the [SEC’s] staff, we were able to put into language the bill that was presented to you.”).

12. See, e.g., Paul Royce, Dir., Div. of Inv. Mgmt., Keynote Address at the FEFSI General Membership Meeting (Sept. 22, 2000) (transcript available on the U.S. Sec. and Exch. Comm’n website: <https://www.sec.gov/news/speech/spch402.htm>) (“[T]he reach of the . . . Act extends beyond mere disclosure and reporting requirements. It places substantive restrictions on virtually every aspect of the operations of investment companies; their governance and structure, their issuance of debt and other senior securities, their investments, sales and redemptions of their shares, and, perhaps most importantly, their dealings with service providers and other affiliates.”).

13. See, e.g., Jaretzki, *supra* note 5, at 303 (“[T]he Act must be read in the light of the nature of the industry and the problems sought to be corrected.”).

the Act, particularly when considering novel situations or whether, per the “rubber” built into the Act,¹⁴ exemptive or other relief is appropriate. In these instances, harnessing the history and purpose of the Act can help advisers, fund directors, practitioners, and regulators apply the Act and ensure that funds remain a driver of national and, most importantly, investor gain.

I. PRINCIPLE NO. 1: PREVENTING OVERREACHING BY FUND INSIDERS

As mentioned above, an adviser generally manages the daily affairs of its funds, which do not have employees of their own and instead rely on the adviser to provide the services necessary for their operation. Such day-to-day management, however, creates an “opportunity for gross abuse by unscrupulous persons.”¹⁵ This is because a rogue adviser, acting through the same employees who run the fund, can force the fund to do as the adviser pleases.¹⁶ With “self-dealing” leading to losses for fund shareholders,¹⁷ the SEC and the fund industry recommended that the Act include strategic measures to implement independent oversight of fund management as well as targeted measures to address common forms of self-dealing.¹⁸

14. Commissioner Robert A. Healy, in his testimony before the Senate, proffered that due to the complexity associated with funds, “the Senators will find that it is necessary to put a little rubber into the bill for the exceptional, unforeseeable and unpredictable cases.” *Senate Hearings*, *supra* note 5, at 45, 313; *see also House Hearings*, *supra* note 9, at 120 (Schenker noted Section “6(c) is the broad exemptive power in the Commission which was deliberately inserted with the universal approval of the industry, to give the power to the Commission to meet situations which were not known.”). Section 6(c) authorizes the SEC “to exempt any person, security, or transaction” from the provisions of the Act when doing so is “appropriate in the public interest and consistent with the protection of investors and the purposes” of the Act. This “rubber” can also be found in “no-action” relief. If an industry participant is unsure of the legality of an action, the participant may pose the question to the SEC staff and ask for a no-action letter stating that based on the facts involved, the “SEC staff would not recommend that the Commission take enforcement action against the requester . . .” U.S. SEC. & EXCH. COMM’N, NO ACTION LETTERS, <https://www.investor.gov/introduction-investing/investing-basics/glossary/no-action-letters>.

15. *House Hearings*, *supra* note 9, at 59 (Healy).

16. SEC REPORT, *supra* note 3, at 1918 (“In practice, the individuals holding management contracts have a dominating influence over the assets and investment policies of an investment company so long as the contract endures.”).

17. *Senate Hearings*, *supra* note 5, at 216 (L.M.C. Smith, Associate Counsel of the SEC Report, describing “statistical proof that these fellows go back to their investment companies when they need money”); *see also* SEC REPORT, *supra* note 3, at 22 (collecting examples of self-dealing). Self-dealing was even problematic when advisers sought to act fairly. *See* S. REP. NO. 76-1775, at 7 (“The industry recognized that, even for the most conscientious managements, transactions between these affiliated persons and the investment companies present many difficulties.”); *see also Senate Hearings*, *supra* note 5, at 207 (Smith noted that “some of the serious losses have come from people who have tried to carry water on both shoulders, whose integrity I do not attack, but who have tried to act in a dual capacity and serve their own interest at the same time that they have served the investment trust.”).

18. Comment, *supra* note 7, at 446 (noting the Act contains several provisions that “directly attack the most obvious single weakness in former investment company practice—the complete lack of uniform provision for insuring the independence of management and its fidelity to its own stock-

Congress agreed and made independent directors the “cornerstone”¹⁹ of the Act’s efforts to combat self-dealing.²⁰ Independent directors are meant to serve “in the role of . . . watchdogs [and] ‘furnish an independent check upon’” fund management.²¹ This is why Section 10(a) requires that 40% of a fund’s board of directors have, for example, no “material business or professional relationship[s]” with the fund or its adviser.²² Notably, the 40% quota²³ is strengthened by the requirement in Section 15(c) that a majority of a fund’s independent directors approve significant transactions, such as the fund’s advisory and underwriting contracts.²⁴

Section 16(a) works hand-in-hand with Sections 10 and 15 by requiring shareholders to elect fund directors at meetings called for that purpose. Section 16(a) thus provides shareholders with a say on fund management while also

holders”); *see also* U.S. SEC. & EXCH. COMM’N, DIV. OF INV. MGMT., PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION, at 473 (1992) (“The restrictions on affiliated transactions were enacted in 1940 in response to a wide array of abuses that occurred in the 1920’s and 1930’s.”) [hereinafter 1992 SEC REPORT].

19. *Burks v. Lasker*, 441 U.S. 471, 483 (1979).

20. *House Hearings*, *supra* note 9, at 109 (Schenker testified that “I think that is one of the most salutary provisions in this bill.”); *Senate Hearings*, *supra* note 5, at 215 (Smith testifying independent directors mitigate the occurrence of transactions where a fund’s interests do not come first); *see also* Jaretzki, *supra* note 5, at 319–20 (noting the purpose of Section 10 is “(1) that it is desirable that all investment company transactions be subject to the scrutiny of at least a minority of directors independent of the management and (2) that in cases where affiliations of directors might involve conflicts of interest, stockholders are entitled to the protection afforded by the existence of a majority of disinterested directors”).

21. *Burks*, 441 U.S. at 484 (quoting *House Hearings*, *supra* note 9, at 109). In 1970, after further cooperation between the SEC and the fund industry, Congress amended the Act to reflect the lessons learned from the “dramatic surge of growth” of funds following World War II. *See* S. REP. NO. 91-184 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4897, 1970 WL 4899–900. The 1970 Amendments introduced a new check on fund management by creating Section 36(b), which “imposed upon investment advisers a ‘fiduciary duty’ with respect to compensation received from a mutual fund, and granted individual investors a private right of action for breach of that duty.” *Jones*, 559 U.S. at 340 (citations omitted). For a discussion of the legislative history regarding Section 36(b), *see generally* William P. Rogers & James N. Benedict, *Money Market Management Fees: How Much is Too Much*, 57 N.Y.U. L. REV. 1059 (1982).

22. 15 U.S.C. § 80a-2(a)(19)(A)(vii), (B)(vii). The 1970 Amendments also raised the bar for qualifying as an independent director by requiring such persons to be “disinterested” from, in addition to “unaffiliated” with, fund management. *See* S. REP. NO. 91-184 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4897, 1970 WL 4927–29.

23. In practice, independent directors now comprise 75% or more of most fund boards. *See* INV. CO. INST. & INDEP. DIRS. COUNCIL, OVERVIEW OF FUND GOVERNANCE PRACTICES, 1994–2018, at 6 (2019). Although the SEC tried to increase the 40% quota to 75% with the adoption of Rule 0-1 in 2004, the portion of the rule pertaining to the quota was invalidated after a judicial challenge. *See Chamber of Commerce v. Sec. Exch. Comm’n*, 412 F.3d 133, 137, 144 (D.C. Cir. 2005) (also invalidating requirement that boards have independent chairs).

24. Another addition through the 1970 Amendments, Section 15(c) requires a fund board “to request and evaluate,” and the adviser “to furnish, such information as may reasonably be necessary to evaluate” advisory contracts; *see also* S. REP. NO. 91-184 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4897, 1970 WL 4903.

preventing directors from secretly resigning and being replaced with adviser-friendly nominees.²⁵ Although the Act allows funds to appoint directors without a shareholder vote if board vacancies occur between shareholder meetings, the Act prevents the exception from swallowing the rule by requiring that, after any such appointments, at least two-thirds of a board be comprised of directors who have been elected by shareholders.

To prevent the reoccurrence of the types of self-dealing that occurred prior to 1940, Congress also adopted the SEC's and the fund industry's suggestions for the Act to include:

- Section 15(a), to stop rogue advisers from increasing fund advisory fees without shareholder approval,²⁶ selling their advisory contracts to the highest bidder without shareholder approval,²⁷ and utilizing evergreen advisory contracts²⁸;
- Section 17(a), to prevent rogue advisers from “dumping” their own unmarketable securities on their funds,²⁹ offloading a flagship fund's poorly performing investments to another one of their funds,³⁰ or merging one of their funds into another fund that pays the adviser higher fees;³¹

25. See *Senate Hearings*, *supra* note 5, at 254 (Schenker testified as to how “seriatim” resignations and appointments of directors kept shareholders “in ignorance of changes or transfers of control.”); *id.* at 79–80 (statement of Hugh Fulton, federal prosecutor, testifying as to importance of fund director elections); see also SEC REPORT, *supra* note 3, at 1877–78.

26. See Am. Century Inv. Mgmt., SEC Staff No-Action Letter, 2016 WL 7404628 (Dec. 20, 2016).

27. See S. REP. NO. 76-1775, at 7 (“[A]fter investors have invested in companies on their faith in the reputation and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who were subsequently guilty of gross mismanagement of the companies.”).

28. See *Senate Hearings*, *supra* note 5, at 38 (Healy testified that “[i]nsiders give themselves long-term management contracts.”); see also SEC REPORT, *supra* note 3, at 1920–21.

29. See *Senate Hearings*, *supra* note 5, at 34 (Healy testifying to the “unloading of worthless securities and other investments of doubtful value upon the companies”); *id.* at 259 (Schenker providing example of insiders selling a stock that “was not doing well” to their fund at a substantial “premium above market”); see also Jaretzki, *supra* note 5, at 317–18 (“[T]here have been instances of investment houses selling securities to affiliated investment companies under circumstances which at worst constituted a conscious unloading of securities on the investment company and at best a bad bargain for the investment company.”).

30. See *Senate Hearings*, *supra* note 5, at 260 (Schenker testified that “if one investment trust dominates the other investment trust, he should not be able to sell securities to the dominated investment trust without any scrutiny.”).

31. Investment Company Mergers, Investment Company Act Release No. 25259, 66 Fed. Reg. 57601, 57604 (proposed Nov. 15, 2001) (codified at 17 C.F.R. § 270.17a-8) (“A merger could result in an increase in fees and expenses borne by shareholders.”).

- Section 17(e), to prohibit rogue advisers from routing fund transactions to an affiliated broker-dealer that would charge the fund outsized commissions;³²
- Section 10(f), to prevent rogue advisers from forcing funds to purchase securities underwritten by an adviser affiliate at unmarketable prices;³³
- Sections 17(f) and 17(g), to guard against insiders stealing fund assets by governing the custody of fund assets and authorizing fidelity bonds, respectively;³⁴
- Section 21, to shield funds from having to loan money or property to their advisers, often on unfair terms;³⁵

32. See *House Hearings*, *supra* note 9, at 110 (Schenker testified that an adviser with an affiliated broker-dealer “may be motivated rapidly to turn over the portfolio of the trust, ‘churn it,’ in order to increase its brokerage commissions.”); see also Jaretzki, *supra* note 5, at 318 (“Charges were made that securities of investment companies were turned over rapidly, that is to say, frequent switches were made in investments, not with a primary view to the good of the investment company, but with one eye on brokerage commissions to be derived.”); Russell Inv. Mgmt., SEC Staff No-Action Letter, 2016 WL 7321814 (Dec. 16, 2016) (“Section 17(e) was designed to eliminate the potential for self-dealing that exists when a person affiliated with a [fund] receives compensation in connection with transactions involving such [fund].”).

33. See *Senate Hearings*, *supra* note 5, at 213 (Smith testified that it “creates a great many difficulties, when the investment company is in partnership with somebody who is in the underwriting business, who cannot afford to have long-term investments, and who is interested in it.”); see also *House Hearings*, *supra* note 9, at 110 (Schenker testified that an adviser with an investment banking affiliate “may be impelled to have the investment company make an investment, not based upon investment quality of that investment, but because the particular investment may give him an ‘in’ to get the banking business from the company whose securities the investment company bought.”); Exemption for the Acquisition of Securities During the Existence of an Underwriting or Selling Syndicate, Investment Company Act Release No. 22775 (July 31, 1997) (codified at 17 C.F.R. § 270.10f-3) (noting fund “assets also could be used to absorb the risks of an underwriting in more subtle ways, such as by facilitating price stabilization in connection with an underwriting”). L.M.C. Smith, Associate Counsel of the SEC Report, referred to this as a fund “being used, so to speak, as a bird dog for the investment banker” to drum up interest in a security controlled by an affiliate in an effort to spur additional sales of the security. See *Senate Hearings*, *supra* note 5, at 222.

34. See *House Hearings*, *supra* note 9, at 57 (Healy testified that due to the liquid nature of their assets, “an investment trust is often merely a safe-deposit box, and experience has proved, rather unhappily for some, that it is not too difficult to loot those boxes and to get away with their contents.”); see also *Senate Hearings*, *supra* note 5, at 264 (Schenker describing sponsor embezzling from a fund); Custody of Investment Company Assets Outside the United States, Investment Company Act Release No. 21259 (July 25, 1995) (codified at 17 C.F.R. § 270.17f-5) (noting that Section 17(f) is intended to ensure fund assets are “kept by financially secure entities that have sufficient safeguards against misappropriation” (citation omitted)).

35. See *Senate Hearings*, *supra* note 5, at 284–85 (statement of John H. Hollands, SEC Attorney, testifying that Section 21 “deals [with] the problem of loans made for ulterior motives”); *id.* at 37 (Healy testifying to the presence of “loans which investment companies have been caused to make to insiders”); *id.* at 207 (Smith testifying to same); see also Jaretzki, *supra* note 5, at 327 (Section 21 “prevents in effect what are known as upstream loans, that is, loans from a subsidiary to a parent or to some company controlled by the parent.”).

- Sections 22(g) and 23(a), to forestall a rogue adviser from forcing a fund to offer it and other insiders fund shares on unfair terms;³⁶
- Section 12(b), to preclude rogue advisers from using fund assets to pay for distribution expenses to grow the fund in an effort to increase advisory fee revenue;³⁷ and
- In a subsequent addition, Section 17(j), which together with Rule 17j-1, prohibits insiders from using material non-public information to “front run” a fund.³⁸

Significantly, the Act relies on independent directors to reconcile the fact that a fund often benefits from the relationships that it has with its adviser, other funds managed by its adviser (“related funds”), and other adviser affiliates. This is why certain rules under the Act—known as the “Exemptive Rules”—allow conduct that is otherwise prohibited by the sections discussed above.³⁹ The Exemptive Rules protect shareholders, however, by conditioning a fund’s ability to rely on them “on the approval or oversight of independent direc-

36. See *Senate Hearings*, *supra* note 5, at 264 (Schenker noting this section stops the “practice in the old days of issuing stock of investment companies for personal service”); see also Jaretzki, *supra* note 5, at 327 (“It is evident that the prohibition against issuing securities for services or property other than cash and securities was designed to eliminate the possibility of overreaching or fraudulent practices on the part of so-called insiders.”); *id.* at 328 (noting closed-end funds were prohibited from selling shares at below net asset value because “the issuance of common stock to favored persons at less than true value was not an imaginary evil”).

37. See *House Hearings*, *supra* note 9, at 112 (Schenker noting Section 12(b) “protects the open-end company against excessive sales, promotion expenses, and so forth”); Inv. Co. Inst., SEC Staff No-Action Letter, 1998 WL 1543541 (Oct. 30, 1998) (“When a fund pays these expenses, the fund’s investment adviser is spared the cost of bearing the expenses itself, and the adviser benefits further if the fund’s expenditures result in an increase in the fund’s assets and a concomitant increase in advisory fees.”) (citing Bearing of Distribution Expenses by Mutual Funds, Investment Company Act Release No. 10252, 43 Fed. Reg. 23589 (May 23, 1978)); see also Jaretzki, *supra* note 5, at 324–25 (“[T]he Commission was particularly fearful of the possibility that open-end investment companies in their formative stages might be made to shoulder the unprofitable burden of selling and distributing their shares during this period of heavy expense and small return.”). When the fund industry was faring poorly in the late 1970s, the SEC enacted Rule 12b-1 to permit the use of fund assets for distribution subject to independent director oversight. See 1992 SEC REPORT, *supra* note 18, at 320–22.

38. Section 17(j) was added to the Act through the 1970 Amendments, see S. REP. NO. 91-184 (1970), reprinted in 1970 U.S.C.C.A.N. 4897, 1970 WL 4924, but addressed conduct that was present in 1940, see *Senate Hearings*, *supra* note 5, at 304 (Schenker testified that, while many funds already prohibited this, the SEC had found instances where insiders “trade in the securities or buy securities a little before the investment trust does, so that the insider is getting a free ride on the purchases of the stock by the investment trust.”).

39. Jaretzki, *supra* note 5, at 321 (“Any sweeping prohibition may involve hardship and unreasonable restraints and instead of protecting stockholders may, in specific cases, work to their disadvantage by preventing desirable transactions.”); see also Indep. Dirs. Council and Mut. Fund Dirs. F., SEC Staff No-Action Letter, 2010 WL 4338476 (Nov. 2, 2010) (“A number of provisions of the Act and rules thereunder rely on fund boards to protect fund shareholders in conflict of interest situations.”).

tors,”⁴⁰ which discourages overreaching while allowing funds to best serve shareholders. A few examples⁴¹ of the Exemptive Rules include:

- If one fund desires to sell a security at the same time a related fund desires to buy it (or vice versa), both funds will benefit by avoiding brokerage commissions if the funds can transact directly. Rule 17a-7 thus allows such affiliated transactions provided parameters are met to ensure that securities are bought and sold at “current market price”;
- If a fund is faring poorly and would benefit from merging into a related fund (which could lead to lower combined fund expenses), it would be short-sighted to prohibit the transaction solely because the funds are affiliated. This is why Rule 17a-8 permits mergers involving affiliated funds subject to independent director approval;
- If an adviser affiliate is a broker-dealer, it would be ill-advised to reduce a fund’s liquidity options by forcing it to ignore that entity. This is why Rule 17e-1 permits the use of affiliated broker-dealers provided parameters are met to ensure that the commissions paid by a fund are “reasonable and fair”;
- If a fund wishes to participate in an investment opportunity that is underwritten by an adviser affiliate, it would penalize shareholders to foreclose the opportunity. This is why Rule 10f-3 allows funds to purchase such securities provided that the fund pays no more than other purchasers, among other requirements; and
- If related funds can save shareholders money and reduce administrative burdens by purchasing joint liability insurance policies and joint fidelity bonds, it would benefit no one to require separate policies for each fund. This is why Rules 17d-1(d)(7) and 17g-1 permit joint policies subject to independent director approval.

40. Investment Company Governance, Investment Company Act Release No. 26520, 69 Fed. Reg. 46378, 46379 (Aug. 2, 2004) (codified at 17 C.F.R. § 270.01). Funds seeking to rely on the Exemptive Rules must also abide by Rule 0-1, which seeks to “provide for greater fund board independence and . . . enhance the ability of fund boards to perform their important responsibilities under each of the rules.” *Id.* Rule 0-1 requires: (1) independent directors to select and nominate other independent directors; (2) counsel to independent directors to meet certain requirements meant to ensure their own independence; (3) boards to perform annual self-evaluations; (4) independent directors to meet on a quarterly basis outside the presence of any interested directors; and (5) have the authority to hire employees, advisors and/or experts. *See* 17 C.F.R. § 270.01 (2019). As enacted, Rule 0-1 also required boards to have independent chairs and be comprised of at least 75% independent directors, but both requirements were invalidated by the judicial challenge referenced in note 23. Nevertheless, most boards now meet these standards. *See* Fund Governance Practices, *supra* note 23, at 6, 10.

41. Other common Exemptive Rules include: Rule 12b-1 (permitting fund assets to be used to pay for distribution); Rule 15a-4 (permitting interim advisory contracts without shareholder approval); Rule 18f-3 (permitting funds to issue multiple share classes); and Rule 23c-3 (permitting the operation of “interval” funds by allowing closed-end funds to repurchase shares from investors).

In this way, the Act and the Exemptive Rules counsel that if a fund would benefit from an affiliated transaction that is structured to prevent overreaching, then the fund should consider seeking exemptive or no-action relief. This is because the Exemptive Rules demonstrate that it is not the affiliated transaction that should be avoided, but rather, the effects of self-dealing. Thus, it makes sense to consider whether such a transaction is worthy of the “rubber”⁴² that allows the Act to adapt to new situations.

II. PRINCIPLE NO. 2: PROMOTING EFFECTIVE DISCLOSURE

Prior to the Act, the absence of regulation regarding shareholder disclosure contributed to rogue advisers engaging in “bait and switch” tactics whereby funds would offer one strategy and then change course without notice to or approval by shareholders.⁴³ Similarly-inclined advisers also oversold key aspects of their funds when advertising.⁴⁴ In response, the Act includes several measures that the SEC and the fund industry recommended to promote effective disclosure that investors can rely on.

It is fitting to start with Section 35(d) which, together with Rule 35d-1, prohibits misleading fund names, such as a “Domestic Equity Fund” investing primarily in foreign bonds.⁴⁵ Next, Section 8(b) requires funds to file registration statements with the SEC, a portion of which serves as a fund’s prospectus and describes, among other things, the fund’s investment strategy, risks, and expenses.⁴⁶ Similar to Sections 11 and 12 of the Securities Act of 1933, Section 34(b) of the Act prohibits untrue material statements and omissions in registration statements, among other filings.

Section 8(b) also requires a fund’s registration statement to disclose significant structural elections and investment policies that impact shareholders. This includes the Section 5(a) election regarding whether a fund is open-ended or closed-ended, which determines how a fund provides its investors with liquidity (*i.e.*, via redeemable shares versus relying on the market, respectively), and the

42. See *supra* note 14.

43. *Senate Hearings*, *supra* note 5, at 234 (Schenker describing a diversified fund becoming a concentrated private equity fund without shareholder notice or approval); S. REP. NO. 76-1775, at 7; see also Comment, *supra* note 7, at 444–45 (“Stockholders who had invested in self-styled diversified companies were committed overnight to highly illiquid positions [in any] business which caught the managerial fancy.” (citation omitted)).

44. See *Senate Hearings*, *supra* note 5, at 83–85 (statement of Carl S. Stern, SEC Attorney, testifying as to misleading advertisements utilized by a leading fund that suffered “staggering” losses); see also Jaretzki, *supra* note 5, at 330 (noting “the character of supplemental sales literature” was one of the “major complaints” discussed during the construction of the Act).

45. *Senate Hearings*, *supra* note 5, at 312 (Schenker). A fund also cannot represent or imply that it is guaranteed or recommended by the federal government. See 17 C.F.R. § 270.35d-1(a)(1).

46. Rule 8b-16(a) functions to keep registration statements current by requiring updates within 120 days of a fund’s fiscal year end. Section 10(a)(3) of the Securities Act performs a similar function by stating that information in prospectuses cannot be more than sixteen months stale.

Section 5(b) election regarding whether a fund is diversified or non-diversified, which determines how concentrated a fund may be in particular securities.⁴⁷

Lastly, Section 8(b) requires funds to disclose their “fundamental” policies and other policies that cannot be changed without a shareholder vote. This includes, among other things, whether a fund’s investments may impact fund liquidity (*e.g.*, can a fund concentrate its assets in specific industries, transact in real estate, or make loans) and how a fund maintains its capital structure (*e.g.*, can it issue senior securities or borrow money). To prevent rogue advisers from unfairly changing these policies and structural elections, Section 13(a) requires consent from a majority of shares to do so.⁴⁸

The Act also imposes ongoing disclosure obligations.⁴⁹ For example, Section 30(e) and Rule 30e-1 require funds to provide investors and the SEC⁵⁰ with semi-annual and annual reports that describe, among other things, information relating to fund holdings, performance, financials, liquidity, and an explanation of why a fund’s directors approved the fund’s advisory contract.⁵¹ These reports are of “fundamental importance” in keeping shareholders informed about their investments, as well as discouraging rogue advisers from taking “improper action” in the course of managing a fund.⁵²

Fund advertising materials are subject to regulatory review for the same reason. Accordingly, Section 24(b) and Rule 24b-3 require certain sales literature to be filed with the SEC or a self-regulatory organization, such as the Fi-

47. See Comment, *supra* note 7, at 444 (“The most important registration and disclosure requirements depend upon this scheme of classification.”).

48. See *House Hearings*, *supra* note 9, at 59 (Healy testified that a “major problem in the case of management companies is created by the absence of any legal requirement for adherence to any announced investment policies or purposes. Such policies have often been radically changed without the knowledge or prior consent of stockholders.”); see also *id.* at 115 (Schenker testifying to same); Jaretzki, *supra* note 5, at 315–17 (“The above provisions are intended to meet this problem by preventing any fundamental change in the character of the business to be conducted without stockholders’ approval.”).

49. See Comment, *supra* note 7, at 442 (noting many fund abuses grew out of “meagre, and often misleading, reports to stockholders”); see also *House Hearings*, *supra* note 9, at 59 (Healy testified that “financial reports to stockholders of management investment companies frequently are deficient and inadequate in many respects and oftentimes misleading.”).

50. See *Senate Hearings*, *supra* note 5, at 303 (Healy testifying this section seeks to avoid situations where the SEC received one annual report while investors received a rosier version).

51. Form N-1A, Items 27(b)–(d).

52. Jaretzki, *supra* note 5, at 341–42 (“The requirements for extensive disclosure in reports to the Commission and to stockholders . . . are very effective restraints on improper action. The prophylactic effect of publicity requirements is too generally recognized to need discussion here. Suffice it to say that even transactions honestly believed to have been entered into in good faith often look quite different in the broad glare of public scrutiny.”); see also *id.* at 338 (“True, the extent to which the average individual is enlightened by the vast amount of information shoved at him by the various securities acts is problematical. But experience seems to indicate that the requirement that such information be given has a salutary effect on corporations and managements, particularly when such information is subject to the scrutiny of a federal agency.”).

nancial Industry Regulatory Association (FINRA), under the assumption that such a submission process “will tend to curb excesses.”⁵³

Notably, a 2019 “no-action” letter regarding an index fund (*i.e.*, a fund that seeks to track the return of a particular index) demonstrates how the Principle of effective disclosure can help to apply the Act.⁵⁴ In this instance, the fund’s subject index was becoming increasingly concentrated in certain stocks, which made it likely that the diversified fund would have to change its Section 5(b) election to that of non-diversified. Due to Section 13(a), this would require shareholder approval, which is costly and risks a change in investment strategy.

As a result, the fund sought no-action relief to forego a shareholder vote and instead disclosed that changes in the index could make the fund more concentrated. By seeking to keep shareholders informed, the fund’s request respected the concerns embodied in Sections 5 and 13 while minimizing the chances for disrupting shareholders. And since requiring a shareholder vote to allow the fund to perform the very task that it promised to shareholders threatened to elevate form over function, the request was granted. In this way, the SEC and the fund worked together to promote the investor protection purposes of the Act while finding a commonsense outcome.

III. PRINCIPLE NO. 3: ENSURING THE EQUITABLE TREATMENT OF SHAREHOLDERS

With funds serving the needs of “Main Street,” the Act seeks to protect investors from sophisticated schemes.⁵⁵ This is evidenced by the Act’s response to “pyramiding,” excessive uses of leverage, voting abuses, and suspensions of the right of redemption.

Prior to 1940, pyramiding was used to employ hostile yet stealthy fund takeovers.⁵⁶ A pyramiding party would invest significantly in a “Small Fund”

53. *Id.* at 330 n.73; *Senate Hearings*, *supra* note 5, at 295–96 (Hollands testified that Section 24(b) “does not attempt to specify what goes into the literature, but merely requires that what goes in it be truthful and not misleading” after describing situations where rogue advisers would, upon SEC request, remove certain statements from prospectuses and “then, promptly, [put] those same representations . . . in the follow-up literature.”).

54. *See* Stradley Ronon Stevens & Young, LLP, SEC No-Action Letter, 2019 WL 2575074 (June 24, 2019).

55. *See* SEC REPORT, *supra* note 3, at 32 (“[A] considerable portion of the capital raised by [funds] represents the participation of widely scattered small security holders, who were virtually powerless to exercise any concerted effort to prevent or eliminate various malpractices and deficiencies, or to remove incompetent or dishonest management.”); *Senate Hearings*, *supra* note 5, at 38 (“[S]eriousness of these abuses [identified by the SEC] is intensified by the fact that holders of investment company securities are peculiarly investors in the low-income brackets.”).

56. *See* SEC REPORT, *supra* note 3, at 2730 (“[T]he unrestricted ability of one investment company to purchase the shares of a similar company opens the way to the application to investment companies of the holding-company device as a means for the centralization of the control and management of such companies. Fundamentally, the use of investment companies as holding companies for other investment companies is a denial of the purported economic function of such companies.”).

in order to gain control through the threat of large redemptions and an outsized influence in director elections. The pyramiding party would then cause the Small Fund to act in its interests or use the Small Fund's assets to invest in and commandeer the assets of a "Large Fund" which, in a repeat of the process, would let the pyramiding party control the Larger Fund and serve its interests to even greater effect.⁵⁷

This was problematic for shareholders who, due to the complicated structures involved, were generally unaware that their investments were being managed to benefit the pyramiding party. Ultimately, this led to a "layering" of fees whereby an investor in the acquiring fund paid that fund's fees in addition to those of the acquired fund⁵⁸ and the pyramiding party engaging in the types of overreaching that inspired the Act.⁵⁹ In response, Section 12(d)(1)(A)⁶⁰ limits the stake that one fund can take in another (no more than 3% of another fund's shares) and how concentrated a fund can be in other funds (no more than 5% of a fund can be invested in one fund and no more than 10% of a fund can be invested in funds generally).⁶¹

57. See *House Hearings*, *supra* note 9, at 112 (Schenker noted that this "situation was not unusual in the past. An Investment Company would buy a controlling interest in B Investment Company, which in turn would buy a controlling interest in C Investment Company. As a consequence, you had pyramiding of investment companies, systems with complicated capital structures with all of the difficulties of pyramided systems.").

58. *Senate Hearings*, *supra* note 5, at 238 (Schenker testified that "[y]ou are not only pyramiding capital structures, but you are pyramiding the management fees. I do not want to appear brusque, Senator, but it seems to me that a situation like this just does not make sense."); SEC REPORT, *supra* note 3, at 2727 (pyramiding led to "uneconomic duplication of management and other operating expenses"); see also 1992 SEC REPORT, *supra* note 18, at 107. The SEC was also concerned that pyramiding deprives shareholders of the ability to receive advice from the adviser they chose, as well as allowing an acquiring fund to circumvent its investment policies by investing in a fund with less restrictive policies. See SEC Report, *supra* note 3, at 2725–26.

59. For example, pyramiding parties influenced funds to: (1) purchase securities in companies that the pyramiding party had an interest in; (2) purchase securities from the pyramiding party on unfair terms; (3) use broker-dealers affiliated with the pyramiding party for fund transactions; and (4) if the pyramiding party managed its own funds, cause any controlled funds to purchase shares of those funds, which led to the pyramiding party receiving additional advisory fees. See Fund of Funds Investments, Investment Company Act Release No. 26198, 68 Fed. Reg. 58226, 58226–27 (proposed Oct. 8, 2003).

60. See 1992 SEC REPORT, *supra* note 18, at 107 ("Section 12(d)(1) is intended to restrict the pyramiding of funds"); see also Jaretzki, *supra* note 5, at 325 ("The most important prohibition in Section 12 is that designed to prevent pyramiding."); *House Hearings*, *supra* note 9, at 112 (Schenker testifying to same).

61. The so-called "3-5-10" limits are the result of the 1970 Amendments and strengthened the original permutation of Section 12(d)(1), which solely focused on registered funds purchasing other funds. Because unregistered funds took advantage of this by taking large positions in registered funds, Section 12(d)(1) was amended to include subsection (A), which imposes the abovementioned limits, and subsection (B), which sets similar limits on registered funds selling their shares to other funds. See S. REP. NO. 91-184 (1970), reprinted in 1970 U.S.C.C.A.N. 4897, 1970 WL 4925.

At the same time, the Act recognizes that funds can benefit from investing in other funds.⁶² For example, an adviser may invest a fund's cash in another fund until a better investment is available or to access a unique investment strategy. Because Section 12(d)(1) may be too restrictive in such cases, the Act and its rules offer exceptions that allow for increased fund of fund investments, but only if an acquiring fund abides by limitations that prevent it from unduly influencing an acquired fund.⁶³ In doing so, the Act succeeds in addressing the abuses associated with pyramiding while preserving a portfolio management tool that can help funds to "meet their investment objectives in an efficient manner."⁶⁴

Section 18 likewise protects shareholders from unfair management practices by regulating fund capital structures and ensuring equitable voting rights. First, subsections (a) and (f) limit how funds⁶⁵ can leverage their assets through the issuance of senior securities.⁶⁶ Prior to the Act, excessive uses of leverage, meant to boost fund returns, often had the opposite effect⁶⁷ due to the way leverage "magnifies" the gain or loss of a transaction—sometimes without limits—and introduces too much of a "speculative character" to retail investments.⁶⁸

62. See *House Hearings*, *supra* note 9, at 112 (Schenker noted that "you may get situations where one investment company may think that the securities of another investment company are a good buy and it was not thought advisable to freeze that type of purchase.").

63. For example, Section 12(d)(1)(F) permits funds to hold up to 3% of the shares of an unlimited number of other funds if the acquiring fund: (1) seeks voting instructions from the acquired fund's shareholders or votes such proxies in the same manner as other acquired fund shareholders (*i.e.*, "echo" votes the shares); (2) agrees to limits on how much and how quickly the acquiring fund can redeem its shares; and (3) abides by limits on the sales load it can charge. More recently, the SEC adopted Rule 12d1-4, which also allows funds to make investments in excess of the limits imposed by Section 12(d)(1) if the acquiring fund abides by control and voting limitations that promote the "protection of investors." Fund of Fund Arrangements, Investment Company Act Release No. 34045 (Oct. 2, 2020) (codified at 17 C.F.R. § 270.12d1-4).

64. Fund of Fund Arrangements, Securities Act Release No. 10590, Investment Company Act Release No. 33329 (Dec. 19, 2018).

65. Section 18 applies different limits to open-end and closed-end funds. In general, Section 18(f) prohibits an open-end fund from issuing or selling any senior security save for borrowing from a bank and subject to maintaining 300% asset coverage of the borrowed amount. For closed-end funds, Section 18(a) prohibits the issuance or selling of any "senior security [that] represents an indebtedness" unless there is 300% asset coverage. Closed-end funds may also issue preferred shares subject to maintaining 200% asset coverage for such shares.

66. The SEC considers derivatives and similar instruments to be senior securities if they result in an "evidence of indebtedness" for purposes of Section 18, as such transactions create "a conditional or unconditional contractual obligation to pay in the future." Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 31933, 80 Fed. Reg. 80884, 80887–90 (proposed Dec. 28, 2015) (citing Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666, 44 Fed. Reg. 25128, 25131 (Apr. 27, 1979) [hereinafter 10666 Release]).

67. See SEC REPORT, *supra* note 3, at 18–19.

68. See *House Hearings*, *supra* note 9, at 69 (Healy noting that "[y]ou do not want these things to be wildly speculative"); see also 10666 Release, *supra* note 66, at 25129 ("Leveraging of an investment company's portfolio through the issuance of senior securities and through borrowing magnifies the potential for gain or loss on monies invested and, therefore, results in an increase in

The SEC, however, has long sought to balance the concerns underlying Section 18 with the “valuable role” that leverage can play in portfolio management, because funds can use derivatives, for example, to hedge risk or obtain efficient exposure to many types of assets.⁶⁹ The SEC thus regulates how funds use derivatives and similar instruments and, pursuant to Rule 18f-4, requires funds to employ, among other things, “formalized” derivatives risk management programs that establish “an outer limit on fund leverage risk.”⁷⁰

Next, by requiring equal voting rights among fund shares, the “one share, one vote” principle enshrined in Section 18(i) ensures that shareholders remain on proportionately equal footing with each other. The SEC and the fund industry recommended this provision to rectify how small groups of shareholders were found to have received special voting privileges that allowed a minority of shares to control an entire fund.⁷¹ This ensures the viability of Sections 13(a), 15(a), and 16(a), which require shareholder approval to change fundamental policies and structural elections, raise advisory fees, and elect directors, respectively. In this way, Section 18(i) guards against the evils of “taxation without representation” from being visited upon shareholders.⁷²

And, lastly, by including Section 22(e), which requires open-end funds to pay out redemptions at net asset value within seven days, the Act protects one

the speculative character of the investment company’s outstanding securities. Leveraging without any significant limitation was identified . . . as one of the major abuses of investment companies prior to the passage of the Act.”).

69. See Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 34084 (Nov. 2, 2020) (codified at 17 C.F.R. § 270.18f-4) [hereinafter Derivatives Adopting Release].

70. *Id.* Prior to the adoption of Rule 18f-4, the SEC allowed funds to enter transactions that give rise to leverage if funds used “segregated accounts” to “cover” such positions. This approach sought to institute a “practical limit on the amount of leverage” a fund can have, which, in turn, limits a fund’s “risk of loss.” 10666 Release, *supra* note 66. The new approach relies on, among other requirements: (1) a derivatives risk management program, which is administered by a fund board-approved derivatives risk manager; (2) limits on a fund’s leverage risk, as calculated pursuant to a “value at risk” test that seeks to “analyze whether a fund is using derivatives transactions to leverage the fund’s portfolio” as opposed to other purposes that “may be less likely to raise the concerns underlying Section 18”; (3) annual fund board oversight of a fund’s use of derivatives; and (4) SEC reporting obligations on a fund’s use of derivatives. See Derivatives Adopting Release, *supra* note 69.

71. See *Senate Hearings*, *supra* note 5, at 240 (Schenker describing “one of the numerous instances that persuaded us to make provision that the persons who really own the company, at least ought to have a vote in some instances”); see also *id.* at 71–72 (Fulton testifying to the use of voting classes to permit a small class of holders to exercise control over funds); *id.* at 218 (Smith testifying to same); SEC REPORT, *supra* note 3, at 1875–96 (same); Jaretzki, *supra* note 5, at 333 (same).

72. This is particularly helpful for shareholders who face “impediments to redemption” and may be reluctant to vote with their feet due to, for example, the tax implications associated with fund redemptions. See 1992 SEC REPORT, *supra* note 18, at 260, 273, 276. Section 18(i) protects such shareholders by ensuring that each has notice of and a say in any changes that stand to “dramatically alter[] the nature of the shareholders’ investment, requiring in effect, a new investment decision.” *Id.* at 273.

of the “defining characteristics” of open-end funds.⁷³ Prior to the Act, rogue advisers would advertise their open-end funds as offering redeemable shares, but then close funds to thwart redemptions and preserve their management fees.⁷⁴ This is why Section 22(e) provides that, absent extraordinary circumstances, open-end funds cannot suspend the right of redemption or unfairly delay payment of redemption proceeds, which ensures that a shareholder’s investment remains the province of the investor.⁷⁵

Taken together, the Act’s responses to pyramiding, excessive uses of leverage, voting abuses, and suspensions of the right of redemption evidence the belief of Congress, the SEC, and the fund industry, that shareholders deserve a fair deal. By preventing the use of public funds for insider gain (the result of pyramiding and voting abuses), speculation (the result of excessive uses of leverage), and illiquidity in open-end funds (the result of suspensions of the right of redemption), the Act seeks to let investors focus on using funds to help their lives as opposed to avoiding sophisticated business schemes.⁷⁶

CONCLUSION

For the past eighty years, the Act has served as a successful regulatory framework because its provisions are commonsense measures meant to solve real-world problems. By highlighting those problems and adding context for the Act’s provisions, the three guiding Principles make the Act more accessible because it is easier, if not instinctive, to apply rules that make sense.

To ensure another successful eighty years, in addition to remembering why the Act was necessary, we should remember how the Act was created—as a product of extraordinary cooperation between the SEC and the fund industry. By engaging in “intensive,”⁷⁷ “constructive,” and good faith⁷⁸ discussions, the SEC and the fund industry forged compromises that have kept pace with eco-

73. See SEC REPORT, *supra* note 3, at 799–801 (collecting examples of redemption gates).

74. See *Senate Hearings*, *supra* note 5, at 291 (Schenker describes instances where “although the fellow . . . bought it in reliance upon the fact that he could come to the company and tender his certificate and get the value of the certificate upon request, there is buried somewhere in the trust indenture a provision saying that the management under certain circumstances can either suspend it for a short period or, in some instances, for a comparatively long period.”).

75. Although most open-end funds pay out redemptions in less than seven days, to further protect investors, the SEC adopted Rule 22e-4 in 2016, which among other things, requires funds to institute liquidity risk management programs in an effort to reduce “the risk that a fund will be unable to meet its obligations to redeeming shareholders . . . while also minimizing the impact of those redemptions on the fund.” Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315, 81 Fed. Reg. 82, 142–43 (Nov. 18, 2016) (codified at 17 C.F.R. § 270.22e-4).

76. Cf. ROBERT A. CARO, *THE YEARS OF LYNDON JOHNSON: THE PATH TO POWER* 39 (Vintage Books 1982) (describing the role of government as a helping force “when men found themselves at the mercy of forces too big for them to fight alone”).

77. S. REP. NO. 76-1775, at 1.

78. See *House Hearings*, *supra* note 9, at 63 (Healy).

conomic cycles, technological advances, and product innovations. As asset management grows more complex, which will challenge both the fund industry and the SEC, we should keep in mind that our framework works best when we work together.

In this way, it is apt to end with the words of Senator Robert F. Wagner, then Chairman of the Senate Committee on Banking and Currency and the Subcommittee that oversaw the Act's creation, who reflected on the cooperation that made the Act possible by noting that: "notwithstanding people may appear to be very far apart . . . when they actually sit down at a table and look at one another and talk to one another, in 99 cases out of 100 they reach an agreement. I think all too often we keep apart when we should sit down and talk things over."⁷⁹

79. See *Senate Hearings*, *supra* note 5, at 1130; *accord id.* at 1122 (Healy testifying "if you can sit down around a table with a group of people who are interested in a particular subject and discuss what a rule ought to be, I think you accomplish a great deal more than when you make a formal record and have a lawyer make a speech.").

